



SacksTierney P.A.
ATTORNEYS

4250 N. Drinkwater Blvd., Fourth Floor • Scottsdale, AZ 85251

Celebrating 50 Years of Service to Our Clients and Community

Stephen J. Anthony
James W. Armstrong
Adrian L. Barton
Steven R. Beeghly
Stephen Aron Benson
Brian E. Ditsch
Judith M. Dworkin
Patty A. Ferguson



0000108247

Jeffrey S. Leonard
Tiffani E. Lucero
Shannon M. Mason
Daniel B. Mestaz
Kristi M. Morley

Sharon B. Shively
Joanne Trifilo Stark
David C. Tierney
Sarah J. Tschider
Julianne C. Wheeler

**Admitted only in Ohio*

Marvin S. Cohen (1931—2009)

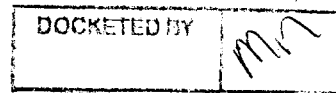
Gary E. Pace, CLM, Executive Director

ORIGINAL

March 8, 2010

Arizona Corporation Commission
DOCKETED

MAR - 8 2010



Writer's Direct Line: 480.425.2615
Writer's Direct Facsimile: 480.425.4915
Writer's E-mail: Judith.Dworkin@SacksTierney.com

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Re: Arizona-American Water Company
Docket No. W-01303A-09-0343 and SW-01303A-09-0343

To Whom It May Concern:

The Anthem Community Council hereby submits for filing an original and fifteen (15) copies of the prepared Direct Testimony of Dan L. Neidlinger, together with Exhibits DLN-1 and DLN-2 thereto. Copies of this testimony and exhibits will also be hand-delivered, emailed or mailed to all known parties of record in the aforesaid proceedings.

Please advise the undersigned if you have any questions regarding this transmittal or the enclosed testimony and exhibits. Thank you for your assistance.

Sincerely,

Lawrence V. Robertson, Jr.

and

Judith M. Dworkin
Sacks Tierney P.A.
Attorneys for Anthem Community Council

By:
Judith M. Dworkin

RECEIVED
2010 MAR -8 P 3:47
AZ CORP COMMISSION
DOCKET CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

2010 MAR -8 P 3:47

AZ CORP COMMISSION
DOCKET CONTROL

COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON FOR
UTILITY SERVICE BY ITS ANTHEM WATER
DISTRICT AND ITS SUN CITY WATER
DISTRICT.

DOCKET NO. W-01303A-09-0343

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON FOR
UTILITY SERVICE BY ITS ANTHEM/AGUA
FRIA WASTEWATER DISTRICT, ITS SUN CITY
WASTEWATER DISTRICT AND ITS SUN CITY
WEST WASTEWATER DISTRICT.

DOCKET NO. SW-01303A-09-0343

**DIRECT TESTIMONY OF
DAN L. NEIDLINGER**

Q1. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A1. My name is Dan L. Neidlinger. My business address is 3020 North 17th Drive,
Phoenix, Arizona. I am President of Neidlinger & Associates, Ltd., a consulting firm
specializing in utility rate economics.

1 **Q2. PLEASE DESCRIBE YOUR PROFESSIONAL QUALIFICATIONS AND**
2 **EXPERIENCE.**

3 A2. A summary of my professional qualifications and experience is included in the
4 attached Statement of Qualifications. In addition to the Arizona Corporation Commission
5 ("ACC" or "Commission"), I have presented expert testimony before regulatory
6 commissions and agencies in Alaska, California, Colorado, Guam, Idaho, New Mexico,
7 Nevada, Texas, Utah, Wyoming and the Province of Alberta, Canada.
8

9 **Q3. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

10 A3. I am appearing on behalf of the Anthem Community Council ("Anthem"). Anthem
11 has intervened in this proceeding on behalf of over 8,800 of its residents that are water and
12 wastewater customers of Arizona-American Water Company ("AAWC" or "Company").
13

14 **Q4. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS**
15 **CASE?**

16 A4. My testimony addresses the "rate shock" issue confronting the Commission in this
17 case as it relates to the requested water and wastewater increases for the Company's
18 Anthem District. AAWC has requested approximately a 100% increase in water rates and
19 approximately an 82% increase in wastewater rates based on a calendar 2008 test year. By
20 any standard or measure, these increases constitute rate shock that should be, in my view,
21 mitigated.

22 Before discussing this issue, I believe it is appropriate to reference certain legal arguments
23 that Anthem intends to present through its counsel during the course of this proceeding.
24 My understanding in this regard is based upon meetings I have had with Anthem
25 representatives and its counsel. More specifically, it is my understanding that Anthem
26 intends to challenge the legal basis for AAWC's proposed inclusion of the March 2008
27 \$20.2 million AIAC payment to Pulte Homes in rate base for ratemaking purposes in this
28

1 proceeding. This line of argument will be developed and presented by Anthem's counsel
2 through cross-examination of other parties' witnesses, oral argument and/or written briefs.

3
4 **Q5. ARE YOU EXPRESSING AN OPINION ON THE MERITS OF ANY LEGAL**
5 **ARGUMENTS TO BE PRESENTED BY ANTHEM IN THIS CASE?**

6 A5. No. I am not a lawyer and therefore not qualified to express an opinion on these
7 arguments.

8
9 **Q6. IS YOUR CONCERN WITH RESPECT TO RATE SHOCK IN THIS CASE**
10 **BASED SOLELY ON THE LARGE PERCENTAGE INCREASES REQUESTED?**

11 A6. No. When evaluating rate shock, one must consider not only the magnitude of the
12 percentage increase but the dollar impact. In some instances, 100% increases may equate
13 to only a few dollars per month – no rate shock. However, in this case for the Anthem
14 District, the Company is requesting a \$37 per month increase in average residential water
15 bills and a \$38 per month increase in average residential wastewater bills or a total increase
16 of \$75 per month. If approved, these increases would severely impact on the pocketbooks
17 of Anthem's residential customers, and accordingly should be viewed as rate shock.

18
19 **Q7. THE TEST YEAR IN THE COMPANY'S LAST CASE AFFECTING**
20 **ANTHEM, DOCKETS 06-0403, WAS THE CALENDAR YEAR 2005. WHAT**
21 **SIGNIFICANT CHANGES OCCURRED DURING THE THREE-YEAR PERIOD**
22 **BETWEEN RATE CASES, 2005 TO 2008, THAT GIVE RISE TO THE LARGE**
23 **INCREASES SOUGHT BY AAWC IN THIS CASE?**

24 A7. The greatest single change during this three-year period was the refunding of \$20.2
25 million of AIAC to Pulte Homes in March 2008 under the Fourth Amendment¹. The

26
27
28 ¹ Fourth Amendment to Agreement for Anthem Water/Wastewater Infrastructure dated
October 8, 2007.

1 Fourth Amendment required AAWC to refund a total of \$26.9 million -- \$20.2 million in
2 March 2008 and the remaining \$6.7 million in March 2010. The combined water and
3 sewer fair value rate base finding by the Commission in the last case, Decision 70372, was
4 \$56.4 million. Accordingly, this one refunding event during the current test year increased
5 the 2005 rate base by approximately 36%. The remaining \$6.7 refund represents an
6 additional increase of 12% over 2005 rate base amounts. The very large rate increases
7 sought in this case by the Company are to a great extent due to the 2008 Pulte AIAC
8 refund.

9
10 **Q8. HAVE YOU DEVELOPED AN ALTERNATIVE RATEMAKING**
11 **TREATMENT FOR THE PULTE REFUND THAT WOULD PARTIALLY**
12 **MITIGATE RATE SHOCK IN THIS CASE?**

13 A8. Yes. One logical approach to this problem is to remove the water and wastewater
14 plant and related accumulated depreciation associated with the 2008 Pulte refund from
15 plant in service for purposes of ratemaking in this proceeding. The net plant would be
16 "parked" or deferred and then transferred back to plant in service ratably over the five year
17 period of 2009 through 2013. The \$6.7 million refund due in March 2010 would be
18 accorded the same treatment but transferred to plant in service over the five year period of
19 2011 through 2015. Depreciation on all of the Pulte AIAC plant would be stayed until
20 reclassified to plant in service.

21
22 **Q9. HOW WOULD THIS PLANT BE RECORDED ON THE BOOKS OF AAWC?**

23 A9. Since the AIAC was used to fund infrastructure that is recorded in many separate
24 plant accounts, the most efficient accounting would be the establishment of two control
25 plant accounts: one for gross utility plant and one for accumulated depreciation. These
26 would be contra control accounts. The offsetting entries for both gross plant and
27 accumulated depreciation would be recorded in separate plant held for future use accounts.
28 Accumulated depreciation would be based on overall accumulated depreciation percentages

1 at December 31, 2008, the end of the test year. These percentages are 14.93% for water
2 plant and 17.38% for wastewater.

3
4 **Q10. HAVE YOU PREPARED AN ANALYSIS THAT ILLUSTRATES THE**
5 **IMPACT OF THIS ALTERNATIVE RATEMAKING TREATMENT ON THE**
6 **PROPOSED INCREASES IN THIS CASE?**

7 A10. Yes. As shown on the attached Exhibit DLN-1, these plant deferrals coupled with a
8 lower rate of return reduces the requested increase in water revenues from 100% to 58%.
9 Similarly, the increase in wastewater revenues is reduced from 82% to 63%. The Company
10 indicated in response to Anthem's first data request that \$14.9 million of the March 2008
11 refund was water plant and the remaining \$5.3 was wastewater plant. Applying the
12 accumulated depreciation percentages previously discussed, the net plant adjustments to
13 water and wastewater rate base are \$12.7 million and \$4.4 million, respectively, as
14 indicated in the "Adjustments" column on Exhibit DLN-1.

15
16 **Q11. HOW WERE THE WATER AND WASTEWATER DEPRECIATION**
17 **ADJUSTMENTS CALCULATED?**

18 A11. Composite depreciation rates of 2.80% for water plant and 2.92% for wastewater
19 plant were used to calculate the depreciation adjustments. These adjustments, net of
20 income taxes, increase test year operating income for water by \$257,236 and test year
21 operating income for wastewater by \$96,142, as shown on Exhibit DLN-1.

22
23 **Q12. WHY DID YOU ADJUST THE RATE OF RETURN DOWNWARDLY**
24 **FROM AAWC'S 8.53% TO 7.33%, AS SHOWN IN THE "ADJUSTMENTS"**
25 **COLUMN ON EXHIBIT DLN-1?**

26 A12. For illustrative purposes, I have used the rate of return determination of the
27 Commission in Docket No. W-01303A-08-0227 et al, Decision No. 7140. In this very
28

1 recent case encompassing the Company's other districts, the Commission adopted an
2 overall cost of capital of 7.33%.

3
4 **Q13. PLEASE EXPLAIN EXHIBIT DLN-2.**

5 A13. Exhibit DLN-2 shows a schedule of projected transfers of net deferred plant to
6 plant in service from 2009 through 2015. The exhibit includes the additional \$6.7 final
7 refund installment due in March 2010. As demonstrated on this schedule, the alternative
8 ratemaking treatment I am suggesting provides for gradual increases in rate base in contrast
9 to the sudden and dramatic increases in rate base shown in this filing that, in my view, are
10 largely responsible for the resulting rate shock.

11
12 **Q14. DOES EXHIBIT DLN-2 ADDRESS WHAT THE ACCOUNTING**
13 **TREATMENT WOULD BE IF ANTHEM PREVAILED ON THE LEGAL**
14 **ARGUMENTS TO WHICH YOU REFERED IN YOUR ANSWER NO. 4?**

15 A14. No, it does not.

16
17 **Q15. DO YOU HAVE ANY RECOMMENDATIONS AT THIS TIME WITH**
18 **RESPECT TO RATE CONSOLIDATION?**

19 A15. No. On February 10, 2010 I attended a briefing by the Company on a rate
20 consolidation model it has developed but have not examined either the model or other
21 aspects of this issue to the degree necessary to provide specific recommendations at this
22 time. It is my understanding that the Staff will be providing recommendations on the
23 consolidation issue in connection with its rate design testimony in this case. I may have
24 specific comments to make in subsequent testimony on the subject of rate consolidation
25 after reviewing Staff's recommendations and those of the Company and RUCO and
26 consultation with my client.

1 Based on my review of the filing in this case, however, I can conclude at this time that
2 consolidation would provide for more equity with respect to recovery of certain common
3 expenses.

4
5 **Q16. PLEASE EXPLAIN.**

6 A16. The Company, for instance, allocated through the application of its 4 factor formula
7 \$1,158,078 in management fees to Anthem Water and \$1,509,322 to Sun City Water. This
8 allocation results in an annual management fee charge to Anthem of \$136 per customer or
9 double the \$66 per customer charge to Sun City. While recognizing certain economies of
10 scale with respect to fixed overhead costs, I view this large differential as unrealistic and
11 unsupportable. A similar anomaly is observed with respect to the allocation of customer
12 accounting expenses. Customer accounting expenses are essentially all customer-related.
13 The annual per-customer charge to Anthem Water for customer accounting is \$21 in
14 contrast to only \$10 for Sun City Water. Rate consolidation would largely eliminate these
15 cost allocation imbalances.

16
17 **Q17. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

18 A17. Yes, it does.
19
20
21
22
23
24
25
26
27
28

EXHIBIT DLN-1

ARIZONA-AMERICAN WATER COMPANY
ACC DOCKET NOS. W-01303A-09-0343 & SW-01303A-09-0343
ANTHEM WATER & WASTEWATER DISTRICTS

Rate of Return and Utility Plant Adjustments to Partially Mitigate Rate Shock

DESCRIPTION	AS FILED (1)	ADJUSTMENTS	ADJUSTED AMOUNT
WATER:			
Rate Base (2)	\$57,431,984	-\$12,666,752	\$44,765,232
Adjusted Operating Income (3)	439,964	257,236	697,200
Required Rate of Return (4)	8.53%	-1.20%	7.33%
Operating Income Reqmt.	4,898,948		3,281,292
Operating Income Def.	4,458,984		2,584,092
Gross Rev. Conv. Factor	1.6578		1.6578
Increase in Gross Revenues	7,392,104		4,283,907
Adjusted Test Year Revenues	7,356,987		7,356,987
Revenue Increase Percentage	100.48%		58.23%
WASTEWATER:			
Rate Base (5)	\$47,735,732	-\$4,408,870	\$43,326,862
Adjusted Operating Income (6)	-191,785	96,142	-95,643
Required Rate of Return (4)	8.53%	-1.20%	7.33%
Operating Income Reqmt.	4,071,858		3,175,859
Operating Income Def.	4,263,643		3,271,502
Gross Rev. Conv. Factor	1.6561		1.6561
Increase in Gross Revenues	7,061,019		5,417,934

Adjusted Test Year Revenues	8,637,123	8,637,123
Revenue Increase Percentage	81.75%	62.73%

NOTES:

- (1) Per Company Filing
- (2) Pulte Refund - Gross Utility Plant \$14,889,799 Less Accumulated Depreciation (14.93%) of \$2,223,047
- (3) 2008 Depreciation (2.80%) of \$416,914 less Income Taxes (38.3%) of \$159,678
- (4) Adjustment to Reduce Rate of Return to 7.33% per ACC Rate of Return Finding in Decision No. 71410
- (5) Pulte Refund - Gross Utility Plant \$5,336,323 Less Accumulated Depreciation (17.38%) of \$927,453
- (6) 2008 Depreciation (2.92%) of \$155,821 less Income Taxes (38.3%) of \$59,679

EXHIBIT DLN-2

ARIZONA-AMERICAN WATER COMPANY
ACC DOCKET NOS. W-01303A-09-0343 & SW-01303A-09-0343
ANTHEM WATER & WASTEWATER DISTRICTS

Projected Annual Transfers of Net Deferred Plant to Plant in Service

PROJECTED YEAR	DEFERRED NET UTILITY PLANT		
	BEGINNING BALANCE	ADDITIONS (1)	TRANSFERS TO PLANT IN SER.
WATER:			
2009	\$12,666,752		-\$2,533,350
2010	10,133,402	\$4,104,541	-2,533,350
2011	11,704,593		-3,354,259
2012	8,350,334		-3,354,259
2013	4,996,075		-3,354,259
2014	1,641,816		-820,908
2015	820,908		-820,908
			0
			\$10,133,402
			11,704,593
			8,350,334
			4,996,075
			1,641,816
			820,908
WASTEWATER:			
2009	\$4,408,870		-\$881,774
2010	3,527,096	\$1,397,086	-881,774
2011	4,042,408		-1,161,191
2012	2,881,217		-1,161,191
2013	1,720,026		-1,161,191
2014	558,835		-279,417
			\$3,527,096
			4,042,408
			2,881,217
			1,720,026
			558,835
			279,418

2015	279,418	-279,418	0
------	---------	----------	---

NOTES:

(1) March 2010 Pulte Refund:

Water: Gross Utility Plant (74%) of \$4,989,110 Less Accumulated Depreciation (17.73%) of \$884,569
Wastewater: Gross Utility Plant (26%) of \$1,752,931 Less Accumulated Depreciation (20.30%) of \$355,845

DAN L. NEIDLINGER

SUMMARY STATEMENT OF QUALIFICATIONS

I. General:

Mr. Neidlinger is President of Neidlinger & Associates, Ltd., a Phoenix consulting firm specializing in utility rate economics and financial management. During his consulting career, he has managed and performed numerous assignments related to utility ratemaking and energy management.

II. Education:

Mr. Neidlinger was graduated from Purdue University with a Bachelor of Science degree in Electrical Engineering. He also holds a Master of Science degree in Industrial Management from Purdue's Krannert Graduate School of Management. He is a licensed Certified Public Accountant in Arizona and Ohio.

III. Consulting Experience:

Mr. Neidlinger has presented expert testimony on financial, accounting, cost of service and rate design issues in regulatory proceedings throughout the western United States involving companies from every segment of the utility industry. Testimony presented to these regulatory bodies has been on behalf of commission staffs, applicant utilities, industrial intervenors and consumer agencies. He has also testified in a number of civil litigation matters involving utility ratemaking and once served as a Special Master to a Nevada court in a lawsuit involving a Nevada public utility.

Mr. Neidlinger has performed feasibility studies related to energy management including cogeneration, self-generation, peak shaving and load-shifting analyses for clients with large electric loads. In addition, he has consulted with U.S. Army installations on privatization of utility systems and assisted these and other consumer clients in contract negotiations with utility providers of electric, gas and wastewater service.

Mr. Neidlinger has extensive experience in the costing and pricing of utility services. During his consulting career, he has been responsible for the design and implementation of utility rates for numerous electric, gas, water and wastewater utility clients ranging in size from 50 to 30,000 customers.

IV. Professional Affiliations:

Professional affiliations include the American Institute of Certified Public Accountants.